

UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

IN RE: Chapter 11
KB TOYS, INC., et al., Case No. 04-10120 (DDS)
Jointly Administered
Debtors. March 3, 2005 (1 p.m.)
(Wilmington)

TRANSCRIPT OF PROCEEDINGS
BEFORE THE HONORABLE DONAL D. SULLIVAN
UNITED STATES BANKRUPTCY COURT JUDGE

Proceedings recorded by electronic sound recording;
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DEBTORS'
EVIDENCE

<u>WITNESS</u>	<u>DIRECT</u>	<u>CROSS</u>	<u>REDIRECT</u>	<u>RECROSS</u>
William McMahon	86	112 121 252		

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1 THE CLERK: All rise.

2 THE COURT: Good afternoon --

3 MR. WAITE: Good afternoon, Your Honor.

4 THE COURT: -- counsel, ladies, and gentlemen. We
5 have a number of matters scheduled in KB Toys. I'm going to
6 go through the short matters first, and then we'll get into
7 the motion for preliminary injunction. But, go ahead. Go
8 through the short matters.

9 MR. WAITE: Thank you, Your Honor. Joel Waite from
10 Young, Conaway, Stargatt & Taylor on behalf of the debtors.
11 Your Honor, just briefly for the record, the first three
12 items on the agenda were adjourned. Items 4 and 5 were
13 matters for which we filed certificates of no objection. I
14 understand orders have been entered. Item number 6, which is
15 the motion of Broadspire for relief from stay, has been
16 adjourned to the March 29th hearing. Item number 7 is a
17 motion filed by the debtor to reject three non-residential
18 real property leases. There have been no objections filed to
19 that motion. We have had discussions with two of the
20 landlords and have made two modifications to the order.

21 THE COURT: Well, there were a couple of landlords
22 that had something to say about it.

23 MR. WAITE: Well, that was on the 365(d)(4)
24 extension order.

25 THE COURT: Oh.

1 MR. WAITE: This is the motion to reject three
2 leases.

3 THE COURT: Okay. Oh, okay.

4 MR. WAITE: Your Honor, we did make two changes to
5 this order. One of the leases for store number 8210 located
6 in Goldsboro, North Carolina. We have provided in the motion
7 for that lease to be rejected effective as of January 31st.
8 The landlord contacted us regarding that, and we have agreed
9 to modify the order to have that rejection be effective as of
10 February 17th, which is about the time they received the
11 notice of the motion. As --

12 MR. BRANCH (TELEPHONIC): (Microphone not
13 recording.)

14 THE COURT: Pardon me, who's on the phone? Is
15 there anybody participating on the phone?

16 MR. BRANCH (TELEPHONIC): Yes, Your Honor.

17 THE COURT: Would you identify who you are?

18 MR. BRANCH (TELEPHONIC): Dustin Branch
19 representing various landlords.

20 THE COURT: Okay. Is there anybody else on the
21 phone? Okay, we're talking about the landlords now. Go on.

22 MR. WAITE: Your Honor, with respect to the office
23 lease in Marietta, Georgia that was covered by the motion, we
24 have provided for that lease to be rejected as of February
25 28th, which is the date by which we thought we would have

1 vacated the premises. It turns out it's going to take us a
2 little additional time, and we've spoken with the landlord,
3 and they've agreed that we can modify the order to have that
4 lease rejected as of March 15, and with those changes --
5 we've revised the order to reflect that, and we ask that the
6 Court enter that order.

7 THE COURT: Okay. You might provide the order and
8 if you -- anybody interested can assume that it will be
9 signed today. It will be docketed today, and you can date
10 your copy today. Does anybody have any comments about the
11 rejection that we just read off? Okay, go on to the next
12 one.

13 MR. WAITE: Your Honor, items number 8 and 9 are
14 both contested matters, so I'll skip over those for now and
15 move to item number 10, which is the debtors' motion for
16 further extension of the time to assume or reject leases
17 under 365(d)(4). Your Honor's correct in your earlier
18 comments. There were three -- four objections filed to this
19 motion. One of the objections was filed by a landlord,
20 Yellowstone. We had agreed with that party to adjourn that
21 matter over to the end of March as there's some discovery
22 going on with that landlord regarding our motion and a
23 separate motion to compel the day it filed. I believe Your
24 Honor signed the stipulation to that effect yesterday.

25 THE COURT: Okay.

1 MR. WAITE: There were three other objections filed
2 and in addition we had conversations with a number of
3 landlords who did not file objections, and based upon those
4 additional objections and our conversations with other
5 landlords, we have resolved all of those objections by
6 modifying the order to provide that the extension will only
7 run through April 29th without prejudice to further
8 extensions, and we've added in language that was in the prior
9 order regarding our obligation to comply with 365(d)(3). So
10 with those changes, all the objections other than the
11 Yellowstone, which has been continued, have been resolved.

12 THE COURT: Okay. Does anybody have any comment --
13 I take it you have orders or do we have orders today?

14 MR. WAITE: I do have an order today, and I know it
15 was provided to the objecting landlords, and I know Mr.
16 Branch got a copy as well, as he's one of the parties we
17 talked to prior to the objection deadline.

18 THE COURT: Okay. I'll sign it today, and you can
19 date your copy. It will be entered today. Go ahead.

20 MR. WAITE: Your Honor, that leaves the three
21 remaining items, and for those, I'll turn the podium over to
22 Mr. Polebaum of Wilmbur Cutler.

23 MR. POLEBAUM: Good afternoon, Your Honor.

24 THE COURT: You're going to have to excuse me. I'm
25 going to write down your names.

1 MR. POLEBAUM: Yeah. My name is Mark Polebaum.

2 THE COURT: P-o-l?

3 MR. POLEBAUM: P-o-l-e-b-a-u-m.

4 THE COURT: Okay, Polebaum. Go ahead.

5 MR. POLEBAUM: Thank you. And thank you very much,
6 Your Honor, for hearing the debtors on its motion for
7 preliminary injunction. Your Honor, we're here this
8 afternoon on the debtors' request to stay Big Lots from
9 further prosecution of the complaint that it filed on
10 February 9th, 2005 in the Delaware Chancery Court against
11 current and former officers and directors of the debtors as
12 well as certain of the debtor shareholders.

13 MR. TRAUB: Your Honor, may I just be heard one
14 second. I'm Paul Traub, counsel for the Creditors Committee.
15 Why did we skip over the standing motion which we brought,
16 which I think --

17 THE COURT: You know, I'm going to deal with that
18 in connection with the preliminary injunction. In other
19 words, the Committee has asked for authority to sue some of
20 the officers and insiders or at least for permission to do
21 so.

22 MR. TRAUB: Well, to be the appropriate party to
23 bring those actions and to deal with those issues.

24 THE COURT: Well, I understand that, and I didn't
25 mean to ignore you. We're going to talk about what's to be

1 done in this area.

2 MR. TRAUB: I just think that -- I mean, it is on
3 the calendar first, and I think it's really -- a lot of
4 things that the debtors is saying in its preliminary
5 injunction motion, I think when you consider the context of
6 the standing motion, the standing motion is really better
7 heard first, and the reason for that is, the debtor makes
8 some statements in its preliminary injunction motion about
9 the reason for the company's decline, which are totally
10 inappropriate, which compromise issues against the estate,
11 and the proper party to be dealing with those issues in terms
12 of what was the cause of the debtors' demise is the
13 Committee. To let the debtor make those statements is not
14 appropriate until we get standing.

15 THE COURT: I'm going to ask you to sit down until
16 he gets done; okay?

17 MR. TRAUB: Okay.

18 THE COURT: Go ahead.

19 MR. POLEBAUM: Thank you, Your Honor. This
20 preliminary injunction motion as the Court has noted is part
21 and parcel of several other matters that are on for hearing
22 this afternoon, and it really does all raise the question for
23 the Court to decide today, Is this Chapter 11 case going to
24 turn into one big litigation fight with everybody suing
25 everybody or are we going to try to put the litigation off to

1 the side for some short period of time and let the parties
2 with the financial stake in the debtor try to find a business
3 solution to the debtor's Chapter 11 case. As I go through
4 the hearing on the preliminary injunction, Your Honor, we are
5 going to present to the Court evidence concerning where we
6 are in this Chapter 11 case, how close the debtor thinks it
7 is to this case being resolved on a business basis, and that
8 we're able to deal with all of the litigation that is the
9 subject of the Big Lots claim, the litigation that the
10 Committee wants to bring, we can deal with that after the
11 business problems are solved. And the debtors firmly believe
12 that that is the most reasonable and logical way to proceed
13 in this case.

14 THE COURT: Let me ask you something. How is the
15 debtor doing since the filing of the Chapter 11? I
16 understand there have been very great losses, but I could be
17 wrong.

18 MR. POLEBAUM: No, Your Honor, when we were
19 here last in January, we did report to the Court that the
20 debtors did suffer very substantial operating losses. For
21 fiscal year 2004, the debtors suffered an operating loss of
22 \$38 million, approximately, and fiscal 2004 ended in January
23 of 2005. And there's no question that the debtor suffered
24 those losses, and that those losses are unfortunate. However

25 --

1 THE COURT: The reason I ask that is that I'm
2 trying to get a reading on whether this debtor is heading for
3 Chapter 7.

4 MR. POLEBAUM: And, Your Honor -- And Mr. McMahon
5 is here in the courtroom. We've submitted his affidavit, and
6 we also would like to have an opportunity to put him on the
7 witness stand to answer those questions, because those are
8 all very important questions. They're fair questions, and we
9 do need to address them. We don't think this company is
10 heading towards Chapter 7. We think this company can be
11 successfully reorganized, but what we need to do is to get
12 people focused back on reorganizing this company rather than
13 suing everybody.

14 THE COURT: Well, who's here on behalf of Big Lots?

15 MR. MARWIL: Good afternoon, Your Honor. Jeff
16 Marwil, M-a-r-w-i-l, on behalf of Big Lots.

17 THE COURT: Okay. I understand Big Lots was on the
18 Committee. They were represented on the Creditors Committee
19 up until a couple of weeks ago; am I right on that?

20 MR. MARWIL: We were on the Committee until early
21 February, and we resigned from the Committee.

22 THE COURT: Well, I understand that, and I'm going
23 to ask you some more about why you quit. I know there may be
24 a conflict, but I think it may go deeper than that. Okay,
25 thanks. What I'd like to do is pose maybe a question. This

1 case has been in Chapter 11 for fourteen months?

2 MR. POLEBAUM: Approximately fourteen months, yes,
3 Your Honor.

4 THE COURT: And I also understand -- I know very
5 little about it, it's been in Chapter 11 before.

6 MR. POLEBAUM: No, Your Honor, no. KB Toys was
7 never in Chapter 11 before.

8 MR. TRAUB: It's a different toy business. Almost
9 every other toy company you know of has been in Chapter 11.

10 THE COURT: I'm sorry. I don't want to malign the
11 debtor. But, I have to say, the debtor's entitled to --
12 rather wasting a chance to reorganize, and after fourteen
13 months, I'd like to get a reading on how good that chance is,
14 and that has a lot to do with what I'm going to do with
15 respect to the preliminary -- the request for a preliminary
16 injunction and as well as the Committee's --

17 MR. POLEBAUM: Yes, Your Honor, and we do intend to
18 address that issue as part of this preliminary injunction.

19 THE COURT: Well, you tell me -- I don't want to --

20 MR. POLEBAUM: What I would like to do, Your Honor,
21 if I may --

22 THE COURT: Am I going to have a plan? Are we
23 going to have a plan, I should say.

24 MR. TRAUB: I think I missed the particular issue
25 maybe it would be important what the creditors think where we

1 stand in the case.

2 THE COURT: Well, I'll give you a chance in a
3 minute. He's got the floor.

4 MR. TRAUB: I'm just anxious, Your Honor.

5 THE COURT: Okay.

6 MR. POLEBAUM: Yes, Your Honor, we can have a plan
7 of reorganization in this case if people will start focusing
8 on the business. I can't tell you what's happened since
9 February 9th when the Big Lots complaint was filed. Since
10 that time, we've not made progress on negotiating a plan of
11 reorganization because everybody's been focused on getting
12 ready for this hearing. Everybody's been hiring lawyers to
13 represent them, and nobody's focusing on the business. Your
14 Honor, we are in the middle of negotiating a plan of
15 reorganization with a third party. We think that the
16 economic terms -- the economic terms have not been finalized.
17 There are still open issues. We think the parties are fairly
18 close to being able to bring that to fruition, and we think
19 that if everybody would start focusing on that rather than
20 what we're here on this afternoon --

21 THE COURT: Well, you've been focusing on it for
22 fourteen months, and there's been, as I understand it, rather
23 substantial loss of property --

24 MR. POLEBAUM: Yes, Your Honor.

25 THE COURT: -- since the filing and I guess, that's

1 not -- that doesn't recommend me thinking that there's going
2 to be at least a confirmable plan. You may have a plan --

3 MR. POLEBAUM: No, Your Honor, we think the plan is
4 a highly confirmable plan. It provides for a third party to
5 come in to put some new equity into the debtor, to provide an
6 additional loan facility, to distribute some cash to
7 creditors, to distribute a note. We think it's a viable,
8 feasible plan, and we'd like the opportunity to try to bring
9 that to fruition and to file it with the Court. In addition
10 to that, Your Honor, the debtors are also negotiating with
11 some third-party lenders to provides some additional
12 financing to the debtors, and if all else fails, Your Honor

13 --

14 THE COURT: When you say "additional financing",
15 for purpose of financing a plan? A confirmation of a plan?
16 Or the purpose of staying out of the range indefinitely in
17 Chapter 11.

18 MR. POLEBAUM: Your Honor, we think the debtor has
19 three choices, and we're right at the critical point in time
20 where we need to make those choices.

21 THE COURT: How much time do you need?

22 MR. POLEBAUM: We think we need sixty to ninety
23 days to bring this to a conclusion, Your Honor.

24 THE COURT: You know, this is almost the whole --
25 this process is like a distress sale, and, of course, I'm

1 sure there may be people out there waiting to buy the case
2 cheaply, and I don't want to encourage that. But you know, I
3 have no control over the last fourteen months, and so I'm
4 going to say, maybe it's your own fault. But you can take
5 that as a criticism. That can be a criticism on most Chapter
6 11s I guess, but --

7 MR. POLEBAUM: Your Honor, I think I would like the
8 opportunity to be able to tell the Court what has happened
9 during this Chapter 11 case, and we're prepared to do that,
10 and so that the Court understands where the debtor is today
11 and what the choices are before it --

12 THE COURT: Well, my question is, is negotiation a
13 viable option today, and if it isn't, let's get on with it.
14 I'll ask you in a minute. I'll let him finish.

15 MR. POLEBAUM: Yes, Your Honor, I believe that
16 negotiation is absolutely a viable option. There's -- In the
17 early fall of 2004, the debtors recognized that their sales
18 were continuing to lag, and that they needed to refine the
19 strategy and direction of their stores. They weren't
20 performing, and the debtors, in connection with the Creditors
21 Committee, hired a consulting firm called Retail Forward. In
22 fact, I think Your Honor, one of the first things you did in
23 this case, Your Honor, was to approve an extension of their
24 retention. With Retail Forward, Your Honor, the debtors
25 prepared a business plan that changes the format of the

1 stores, changes the merchandise for the stores, changes the
2 signage, and brings a whole new approach to how the KB stores
3 present themselves to consumers. That plan started being
4 implemented in mid-January and really rolled out to all 625
5 stores February 1st. Since February 1st, Your Honor, the
6 debtors' sales, for the first time I believe in fourteen
7 months or perhaps sixteen months, the debtors' sales,
8 comparable store sales year over year have increased. The
9 debtor had not been able to make that happen for at least
10 fourteen months prior to now. It's unfortunate that the
11 business plan only started getting implemented when it did
12 start getting implemented, but it is now in place. The
13 debtor's moving forward with that plan, and the sales have
14 responded fairly dramatically, frankly. Not only are the
15 comparable store sales higher year over year, but as against
16 the debtor's plan, it's about 15 percent over plan. So that,
17 the debtors believe that they are now at this time -- and
18 again, it is unfortunate that it took as long as it did, but
19 we are where we are, but the debtors do believe that their
20 business is now gaining traction, that the sales are firming
21 up, and it has an opportunity to continue as a viable toy
22 retailer in a mall-based environment.

23 THE COURT: And you'll know in the next sixty days
24 whether or not you can put together a confirmable plan; is
25 that --

1 MR. POLEBAUM: Well, I asked for sixty to ninety,
2 Your Honor, but, yes.

3 THE COURT: Sixty to ninety. Okay. Thanks. I'd
4 like to hear from Big Lots, and I'll give the Committee a
5 chance in a minute. I know you're dying to --

6 MR. TRAUB: It's just my personality, Your Honor.

7 THE COURT: By the way, I have read your brief, and
8 I've read all of the briefs that have been furnished to me,
9 and it is my intention to make a decision today, not to take
10 it under advisement. So, if that helps you. Go ahead. How
11 is -- I have a couple of questions of Big Lots.

12 MR. MARWIL: Certainly.

13 THE COURT: Obviously, Big Lots feels that they've
14 been imposed on in connection with the acquisition of these
15 stores, and I -- and you filed a lawsuit, but is it possible
16 -- and I want to thank you for your brief, by the way. You
17 really kind of articulated the priority or at least the level
18 at which the -- what is it, a \$52 million note stands, and of
19 course that leads me to the thought that maybe you didn't
20 realize that until rather late, and -- or your clients didn't
21 or alternatively, you realized that the Committee knew about
22 it and that might have led to the resignation from the
23 Committee and the filing of the lawsuit, but I wonder is
24 there's some disillusionment that occurred.

25 MR. MARWIL: No, Your Honor, I don't think so.

1 Your Honor asked why we resigned from the Creditors Committee
2 --

3 THE COURT: You don't have to tell me, but I have
4 to -- and I can just guess at why.

5 MR. MARWIL: Well, I think that it would not be
6 accurate to say we resigned because of the structural
7 subordination potential with respect to our note. In fact we
8 were aware of that potential and are obviously aware of that
9 potential given the outline in our brief, but for a variety
10 of reasons including the fact that we don't think the debtor
11 is making sufficient progress toward reorganization and we do
12 think that the debtor -- in fact that the Committee, as well,
13 suffered from conflicts of interest that really prohibit them
14 from acting as fiduciaries for the benefit of Big Lots as a
15 HCC creditor in looking at this lawsuit. And it's not just
16 in pursuing the lawsuit as a plaintiff, it is in the
17 deferment of a lawsuit which is the subject of the 105 action
18 as a substantive economic issue that benefits the insider
19 defendants who are in control of the debtor, and that's the
20 problem with the motion itself and the problem with the
21 insider defendants from remaining in control with respect to
22 the motion.

23 THE COURT: I'm going to get to that matter. But
24 what I do want to ask you is, has things gone beyond the
25 prospect of one more chance to negotiate a plan and perhaps

1 resolve maybe not perfectly but at least imperfectly your
2 client's interest?

3 MR. MARWIL: Your Honor, I think if we know that
4 our state court lawsuit is going to proceed a pace, and I
5 think it's important that we all understand how that lawsuit
6 is going to proceed if Your Honor does not enjoin it.

7 THE COURT: Well, I --

8 MR. MARWIL: It's going to take months --

9 THE COURT: Well, I know. I understand --

10 MR. MARWIL: -- before we get into any well beyond
11 the sixty to ninety days before there's any real action in
12 that suit, and for the debtors to come in and say that
13 there's going to be all this activity, we know, based on the
14 papers we've already read, that the defendants are going to
15 file a motion to dismiss, and when they file that motion to
16 dismiss, the Chancery Court Rules say no discovery, and that
17 motion to dismiss is going to be briefed, and the Judge is
18 going to decide that motion over the course of four months,
19 five months, six months. We've already agreed to give the
20 insider defendants a thirty-day extension of their time to
21 answer or to file that motion to dismiss in the action
22 anyway. So, they have what they want just by virtue of how
23 the state court is going to proceed with the action, and on
24 top of that, we offered in our papers, we won't take
25 discovery for ninety days other than getting what you've

1 already delivered to the Creditors Committee, and we said, To
2 the extent that we need to do anything else, we'll come back
3 to Your Honor if we can't get it worked out by agreement, and
4 the debtors have said --

5 THE COURT: Can I assume that in good faith your
6 client will negotiate, assuming an acceptable plan or a plan
7 comes in?

8 MR. MARWIL: It would be easier for us to believe
9 that we could get to an acceptable plan if we are not
10 hamstrung in getting started on our state court lawsuit. If
11 Your Honor issues the stay, and we're not allowed to at least
12 proceed toward that motion to dismiss and, from our
13 standpoint beating the motion to dismiss, we're going to be
14 that much further behind before we're comfortable settling at
15 anything other than a very significant amount of money.

16 THE COURT: You know, I have the feeling that if I
17 do the wrong thing this is going to collapse into an orgy of
18 litigation, and I really would like to do my best to avoid
19 that.

20 MR. MARWIL: I would offer to Your Honor the
21 following: I think the easiest way to avoid litigation in
22 this bankruptcy case is to allow the state court action to
23 proceed the way I just outlined. That's how it's going to
24 go. They're going to file a motion to dismiss, and it's
25 going to take four to six months to brief it and get a

1 decision, and if we can get the hundred thousand pages of
2 discovery that they already have, that are sitting in boxes,
3 and file them somewhere that is not going to take anything
4 other than a copy machine to get us, we're happy.

5 THE COURT: You're talking about that monument of
6 paper --

7 MR. MARWIL: That the Creditors Committee has gone
8 through.

9 THE COURT: -- delivered to the Committee.

10 MR. MARWIL: And if that happens, the state court
11 suit's often -- the state court and the debtor actually then
12 can focus on the reorganization, and, you know, this flurry
13 here today, all these people sitting back here, it's self-
14 induced by the debtor and by the insider defendants. They
15 didn't have to file this adversary proceeding in the 105
16 motion. There's nothing happening of any immediate threat at
17 all in the state court action. They got an additional thirty
18 days to answer.

19 THE COURT: Well, you got their attention.

20 MR. MARWIL: Well, we did.

21 THE COURT: You sure did.

22 MR. MARWIL: Properly so.

23 THE COURT: Okay, listen, I'll get to the
24 preliminary injunction in a minute. I want to hear -- the
25 Committee wants to say something. Maybe you can cover some

1 of the questions I've asked.

2 MR. TRAUB: I'd like to give you some context of
3 where we are, what the real plan negotiations going on are.
4 You came late to the case, and we told you -- actually we had
5 sort of a non-event hearing the first time you were here just
6 to sort of get to know each other and say, Look, we're going
7 to get to the crux of this case the next time that we see
8 you, which we picked February 28th. What's happened in the
9 case that's led to where we are -- and I'm going to tell you
10 very specifically about plan negotiations which you're
11 entitled to know and you'll see how important the standing
12 issue is and how the case will move correctly if you deal
13 with it that way. So, where we've been in this case, we've
14 had numerous extensions of exclusivity. We told you the last
15 time that we had objected to the debtor filing a premature
16 plan because we felt the plan was not viable. Numerous
17 revisions got made. We hired this consultant and the plan is
18 either a good plan, it's worked for three weeks in February.
19 Three weeks in February is not the end of the world. I mean,
20 it's not exactly the highest selling season of toys.
21 Valentine's Day cards are good in February, that's important.
22 Where we're at is as follows: The debtor has always taken
23 the position in this case, and you can see it, and I'm happy
24 to introduce if you haven't seen them, in every extension of
25 exclusivity motion, the debtor has always taken the position

1 that it might be free to settle claims against its insiders.
2 So, what we did, in terms of preserving the status quo to
3 work during these fourteen months on the business, is to say,
4 You know what? We'll put off this standing motion. We have
5 no intention of suing you tomorrow, but you're serious? You
6 really think that there will be a circumstance in which a
7 Board of Directors that is solely made up of insiders and no
8 outside directors that you, the debtor, could reach a
9 settlement with them? That's why we haven't ruled out the
10 possibility. Let's focus on the business and in each
11 stipulation there was a clause that said, Without our
12 consent, they could not compromise claims against their
13 insiders. They then invited us, as the shareholder
14 defendants, directed defendants, to investigate the claim for
15 the purpose of seeing if we could come up with some solution
16 to it. Quite frankly, I thought that part of the solution
17 might have been that they would fund a new value plan,
18 economics would go forward, and we'd have an argument about
19 how much money got distributed because the business would be
20 a little better capitalized. We finished our investigation
21 during the last period -- just before we saw you, and we
22 concluded that the debtor was insolvent at the time in April
23 of 2002 when it distributed \$120 million. From every day
24 thereafter, they were insolvent. That's what our
25 investigation shows. That's what Big Lots is saying. From

1 April 2002, because of taking out that gigantic sum of money,
2 the company was insolvent. We then, as we got to this
3 hearing that you're having today, have been negotiating with
4 one party for the purpose of seeing -- We're down to one
5 party. During the month of January, I'm happy to say, Your
6 Honor, we had two or three hot prospects where I would have
7 come in very present, We have a sale to tell you about that
8 you'll be proud about. It didn't work. We're down to one
9 party. This one party, the crux of what -- Who's doing the
10 negotiation? In all due respect to Mr. Polebaum, we're
11 negotiating. It's for the creditors' benefit. We're the
12 ones who are saying what we need and what has to happen for
13 us to support it, and the critical element that seems to be
14 missing is that nobody will agree that a sum of money should
15 be set aside -- not for today, but as we can see where there
16 is a business deal, a sum of money should be set aside for
17 the purpose of pursuing litigation which we believe is valid
18 and meritorious and either will provide a substantial
19 dividend -- \$120 million goes a long way towards a \$200
20 million debt to navigate an agreement on that. So we tried,
21 you don't know me, Your Honor, but I try to make a deal every
22 day rather than have to have this kind of thing. Up until
23 last Friday, we tried to come to a deal with the debtor which
24 said, Are you now finally willing to waive your right to ever
25 settle with your clients -- I'm sorry, with the insiders?

1 And they said, Yeah, but not under all circumstances. If for
2 instance, the Judge allows that case to go forward and we
3 want to intervene or other events happen, then we get our
4 right back to try to settle with our insiders. I said, Guys,
5 what are you talking about? We're not doing that. So, we
6 went back and forth and back and forth and we started to read
7 these pleadings, and what we're saying, very, very clearly is
8 if you understand the history of a group of -- of a debtor
9 controlled by these insiders, who has up until this last
10 Friday taken the position until they filed their pleadings,
11 that they had the right under certain circumstances to settle
12 against the insiders and promulgate a plan for people to vote
13 on, that's forced our hand. So, now why do I say the
14 standing motion should be heard first? First, most
15 important, you supervise this case. Is there a confirmable
16 plan of reorganization? So long as we don't have standing
17 where we can tell this particular plan funder, Guys, here's
18 what we need. Here's what the business needs. Here's the
19 stuff you can work out with the company in terms of
20 financing, but unless there's a budget that will be in there
21 to be set aside to prosecute claims if they want to prosecute
22 claims -- claims are going to get prosecuted or not -- Unless
23 there's a budget, there can be no business deal. So, for the
24 debtor to come up here and say, We're close to a deal, we're
25 not close. You know why we're not close? Nobody's agreeing

1 to set aside money in these negotiations for the prospect of
2 litigation later down the road. If that doesn't -- The only
3 way that's going to change, if we get standing. Second, most
4 important, and I think will put the case on an even keel, two
5 remaining points: One, we're not looking to start litigation
6 tomorrow. On the other hand, when we read in the debtors'
7 pleadings, the debtors' pleadings that, you know, it's one
8 thing that's a valuable assets of the estate, these causes of
9 action, solvency and everything else, and, you know, we want
10 them for the estate, we the debtor, but really we believe and
11 the word in the affidavit of Mr. McMahon in the other
12 pleadings, that's not the real reason we're here. The real
13 reason we're here is because it was a lousy Christmas season
14 in December of '03. Who cares? The company was insolvent is
15 what we're saying and they're saying in April of 2002. It's
16 a red herring. It means nothing that it was a bad Christmas
17 season. We're all sorry it was a bad season, but the
18 allegation is in April of 2002. So, we're the -- To have
19 them put in papers that says, Oh, yeah, we'd really like it
20 for the company. Keep in mind, while they were putting those
21 papers in was before last Friday, they still weren't
22 conceding that they didn't have the right to settle it
23 themselves, which we wanted. We asked for the rights --
24 Listen if Big Lots settles, do we have the right to -- Do we
25 have standing for that purpose? Well, we're not sure we're

1 willing to give you that. I said, Guys, enough is enough.
2 So, for the two principal purposes of this case, is there a
3 reorganizable case? We must have standing so we can dictate
4 that money gets set aside for litigation.

5 THE COURT: Let me ask you a question.

6 MR. TRAUB: Yeah.

7 THE COURT: As I understand the exclusive period as
8 an exception in favor of the Committee, the Committee --

9 MR. TRAUB: Not the new one.

10 THE COURT: Pardon me?

11 MR. TRAUB: Not the new one.

12 THE COURT: Not the new what?

13 MR. TRAUB: The new one says there's a joint plan.
14 There's an ability of each party, a joint exclusivity, the
15 new proposed issue. The new proposed extension of
16 exclusivity.

17 THE COURT: So what are you saying? Are you saying
18 you have not had the authority to file your own plan?

19 MR. TRAUB: The only way we could have filed a
20 plan, up until now, through this bridge order, is if they
21 filed a plan that we didn't like.

22 THE COURT: Okay, would that help --

23 MR. TRAUB: We need standing. And let me say one
24 other thing I think is important, since you understand --

25 THE COURT: Well, we're talking about filing

1 lawsuits.

2 MR. TRAUB: We're not filing a lawsuit tomorrow.

3 THE COURT: Okay, but a plan though, if that could
4 be opened up so that the Committee -- I mean, it is a plan to
5 say we're going to sue everybody in sight and everybody will
6 be happy --

7 MR. TRAUB: No.

8 THE COURT: If you want to file it, you can do
9 that. You can file a plan that would authorize you to do go
10 ahead, and --

11 MR. TRAUB: Yes, but I could just say one thing to
12 clarify it?

13 THE COURT: Yeah.

14 MR. TRAUB: We're charged -- they make these
15 conflicts of interest things which are just so offensive to
16 me because I want to introduce a document, they'll show you
17 some conflicts of interest that would make your hair -- would
18 make my hair stand up. But in any event -- Sorry about that.
19 I'm going to take my foot out of my mouth. But in any event,
20 we've reached out, there are several major stakeholders in
21 the case: ASM and Angelo Gordon, who bought tens of millions
22 of dollars worth of claims. Early on, Angelo Gordon got
23 under the tent, so to speak, signed a confidentiality
24 agreement. We communicate with them regularly letting them
25 know what's going on. When ASM filed their motion, we

1 contacted their counsel and said, You know what? We're at
2 such a critical phase of the case, it's time that you become
3 ex officio members of the Committee. You are large
4 stakeholders. You got a real handle of what's going on, and
5 we're either going to come up with a reorganizable plan
6 funded deal or, perhaps and hopefully -- I mean, Chapter 7, I
7 don't like that word, but under Chapter 11, an orderly wind
8 down because many businesses that they would participate in.
9 Both of those parties are in court today, both represented by
10 counsel, both of whom support us getting standing today
11 because we can't negotiate a plan with this third-party
12 funder without it, and we can't continue to operate where the
13 debtor's making statements in the public record. You know,
14 it's a wonderful thing that the company was insolvent in '02,
15 but that's not the real reason, there are other reasons.

16 THE COURT: You use the word "standing". Do you
17 mean standing to file a lawsuit against the insiders?

18 MR. TRAUB: Yes.

19 THE COURT: Okay. And standing to file your own
20 plan, if that's what you decide to do.

21 MR. TRAUB: Well, both of those, sure.

22 THE COURT: Huh?

23 MR. TRAUB: Yes, both.

24 THE COURT: Okay.

25 MR. TRAUB: Now, I will say to the Court, and I

1 will say it to everybody present, I believe that in the next
2 thirty to sixty days, we will know whether we can have a
3 consensual deal. If we don't have standing today to bring
4 that lawsuit, it will never happen because we can never come
5 to -- we've been negotiating with this party on two different
6 occasions to eight months. They are not setting aside the
7 money for the litigation which is important to any plan. He
8 wants it. Consolidated wants it. We want it. ASM wants it.
9 Angelo Gordon wants it. That's what creditors want. I don't
10 care what the debtor wants, it has to please creditors to do
11 that. If we have standing today, we will not commence a
12 lawsuit until the end of this period of time to see whether
13 we have a deal. That's our agreement. We will not commence
14 that lawsuit. There will be no distraction whatsoever. But,
15 it will enable us in plan negotiations to say, Listen, guys,
16 we have standing. It's us you need to talk to. And in order
17 for us to agree to a reorganization plan, you have to set
18 aside this money, and where's it's gone, to give you the
19 flavor of it, like in every business deal, Your Honor,
20 there's a --

21 THE COURT: How much money are you talking about?

22 MR. TRAUB: For what?

23 THE COURT: To set aside.

24 MR. TRAUB: Three million.

25 THE COURT: Three million.

1 MR. TRAUB: Yeah.

2 THE COURT: That's a lot of attorney's fees.

3 MR. TRAUB: It's mostly -- you know who it goes
4 mostly to, I mean, is the -- There are professionals of
5 accountants, et cetera, who have to testify as to solvency
6 and other opinions, and, you know what the good news is, Your
7 Honor, you get to rule on all that. If there's not a budget,
8 hopefully not, we'll settle it, maybe. If there's not a
9 budget, these are very deep -- this is one of the biggest
10 private equity funds in the world, if they know we have \$40
11 to sue them, we're not going to last to long. We need a
12 certain amount of money -- we wanted 10 but we've come to 3.
13 We want \$3 million set aside in a fund for the purpose of
14 commencing litigation, and so you're aware, because you're
15 entitled, it's your case, over the last month and over the
16 next month, we have been adding up until our ears -- adding
17 up every penny. How much is it to wind down this? How much
18 to wind down that? How much if we exclude this? How much if
19 we exclude that? And there are a lot of scenarios, there's
20 no money to sue. So, and that's because we don't have the
21 right to do it. We need standing today. We can't have
22 either plan negotiations. They will fail. There's no point
23 in going any further. We cannot do it without standing
24 today.

25 THE COURT: Let me ask you, is it possible that a

1 plan could be negotiated that eliminates your Committee or
2 Big Lots' right to sue the insiders?

3 MR. TRAUB: Yeah, if they settle.

4 THE COURT: Is that a non-negotiable --

5 MR. TRAUB: They have to settle.

6 THE COURT: Oh, they have to settle, that's right.
7 Absent settling.

8 MR. TRAUB: Well, no. I mean, just to give the
9 flavor of it, Your Honor, we negotiated for a year. We made
10 a settlement demand on the defendants. It was, I promise
11 you, not take it or leave it. It was to try to reach a
12 business solution. Haven't heard a word. As a matter of
13 fact, all we hear now is, you know, two or three toy
14 manufacturers are hopelessly conflicted because they didn't
15 investigate unfair pricing in 2003.

16 THE COURT: It's Wal-Mart's fault.

17 MR. TRAUB: It's Wal-Mart and -- you know, Hello.
18 We're saying you were insolvent in 2002, who cares? We'll
19 deal with it later, and in terms of conflicts, Your Honor, I
20 have to point out one thing because there was some nasty
21 remarks made about the Committee. We take ourselves very
22 seriously. I'm prepared to hand up an exhibit. There were a
23 lot of people that got money out of that recap transaction,
24 some officers, don't want to sue them tomorrow. I told you,
25 we'd like to take one last stand once you give us standing to

1 try to present a plan and say, Your Honor, we did a heck of a
2 job. We'll leave this for another day or we'll settle it.
3 Insiders got money. Shareholders got money. The party who
4 is representing Bain, Ropes & Gray, their investment company
5 received almost a million dollars as an investor in the deal.
6 So before people start to throw darts, I'm happy to introduce
7 -- I have an exhibit for everybody.

8 THE COURT: Another time.

9 MR. TRAUB: Before they start throwing darts, we
10 can't do this, we can't do that, we represent all creditors;
11 okay? We have refrained for fourteen months to do a detailed
12 investigation. Why did we do it without seeking authority
13 from day one? Because, as you know, Your Honor, if you can
14 do it in a private board room, here's what we have, nobody
15 has to know much about it, let's come to a deal. Eventually,
16 they said, Well, we still may have the right to settle with
17 ourselves. I said, Guys, we're at the planning stage and you
18 want to settle with yourselves? You've got to be kidding.
19 We can't do that. So we have no conflicts. We represent all
20 creditors. Every major creditor constituency will stand up
21 today and say, Your Honor, if there's going to be a
22 successful plan negotiation -- Traub and his group, they're
23 not suing tomorrow, but let the business part plan out, work
24 on the business. Let them use that as an ability to help
25 negotiate a plan, and each of us will stand up and say we

1 want to actively get involved and see if there's a deal. ASM
2 must have \$15 or \$20 million in claims. Angelo Gordon, \$20
3 or million in claims. Their counsel is here. They're
4 prepared to stand up and support us. Give them standing so
5 that we can negotiate a fair plan. Once we do that, we're
6 going to roll up our sleeves for as long as you give us, and
7 we will either say we can cut a deal --

8 THE COURT: It won't be very long.

9 MR. TRAUB: I don't want it to be very long. How
10 do you like that? I really don't.

11 THE COURT: I have in mind the next three, four,
12 five months. Either we're going to have a proposal --

13 MR. TRAUB: Your Honor, to be honest with you, I
14 have shorter in mind. The company's going to start to lose
15 money. I believe that a couple of months -- and I'll tell
16 you, it's a hundred percent doomed if we don't have standing
17 because there's not enough money to be set aside to protect
18 people's interests. You give us that, we'll work like dogs.
19 We're not commencing suit.

20 THE COURT: I'm assuming when you say standing, you
21 want to make the insiders kick in something.

22 MR. TRAUB: Yes. We are the party to bring that
23 action. We're not going to bring it tomorrow. We're
24 prepared -- even though there were some nasty things said --

25 THE COURT: No, I mean in negotiation, you want --

1 MR. TRAUB: Yes, we're the one.

2 THE COURT: Okay.

3 MR. TRAUB: Nobody else. And, you give us that,
4 we'll roll up our sleeves and try to cut a deal. We'll also
5 commit to not commencing a lawsuit. If the case is not
6 reorganizable in its current form and pieces have to be sold
7 and we have say, you know, somebody, you want to buy 300
8 stores? You want to buy Puerto Rico? You want to buy the
9 wholesale business? At some point down that road, depending
10 on what happens, we may have to commence suit, but we're not
11 here -- we've never said to commence suit until they said,
12 you know what, we were in the final phase of plan
13 negotiations, but we may have the right to settle with
14 ourselves, and now, you know, we'll give up that right, but
15 we want an independent party to investigate that after they
16 authorize us to do all the work. We've done all the work.
17 We're the appropriate party, and if you don't do that, Judge,
18 I mean, you know, we're going to blow ourselves up. We're
19 going to want a Chapter 11 Trustee. We're just going to dive
20 under the covers, and say, we can't function. We've got to
21 be a little more strong-willed than that. They can function.
22 We're not suing them tomorrow.

23 THE COURT: Well, I have in mind a Chapter 7
24 Trustee, and I know that's a bad word, but it --

25 MR. TRAUB: If they want a Chapter 11 Trustee, Your

1 Honor --

2 THE COURT: Chapter 7.

3 MR. TRAUB: Well, we'd like to be able to brief
4 that, but I believe there are several Chapter 11 Trustees, if
5 they really want to run for the hills, that would do an
6 excellent job and we still may get a plan done. I believe
7 that if you give us standing, give us as short a period of
8 time as you think is appropriate so that we can level the
9 playing field, we will not commence suit and then we won't
10 have these kind of statements made that we allege is a
11 substantial asset. They allege is a substantial asset, and
12 saying, Yeah, that's true, but you know what, it's really
13 more important that Wal-Mart attacked us in 2003. It's like
14 saying, you know, we're going to fly to the moon in 2011.
15 Who cares?

16 THE COURT: Can I assume that when you talk about
17 standing your interests are very similar to --

18 MR. TRAUB: Absolutely.

19 THE COURT: -- Big Lots?

20 MR. TRAUB: Just let me say this -- He's a guy who
21 likes to speak for himself, but let me say one thing first:
22 Our interests are not unaligned; okay? They claim that they
23 have a dibs at a certain portion of the claim that we don't.
24 At the end of the day, if there were to be a negotiation, and
25 Mr. Marwil can deal with that, if we were to file the

1 creditor plan, and let's say we move forward, and one of
2 those things I would commit to the Court I would certainly
3 try to do is say, You know what? Let's say the cases could
4 be substantively consolidated and we could do away with some
5 of your structural subordination so that we all share, and
6 the Judge doesn't have to see that your legal bill is six --
7 high, and my legal bill is high. One way to solve that at
8 the end of the day is to figure out -- Right now, do you know
9 why they're upset? You asked that, and I'm going to
10 speculate and he can answer for himself. They're upset
11 because under the debtors' liquidation analysis it shows that
12 their entire plan is structurally subordinated. Who would
13 like that?

14 THE COURT: Whenever it would get to zero.

15 MR. TRAUB: Zero. So, in our plan, I commit that
16 we're not going to do that to them. I mean, he's a nice
17 enough guy. He certainly was nice to us when he was on the
18 Committee. We're going to try to cut a deal -- Who wants to
19 get nothing? So, are our interests the same? They're not
20 identical, but we're on the same side. We think that those
21 guys should kick in some money. It's a question of how we
22 share it.

23 THE COURT: Okay. Thanks. Go ahead, I --

24 MR. POLEBAUM: I would like an opportunity to --

25 THE COURT: I'm going to give you a chance, but I

1 think you may want to respond to what he's going to say.

2 MR. POLEBAUM: No, I don't, actually. I think it's
3 more important to focus on what Mr. Traub has just said.

4 THE COURT: All right.

5 MR. POLEBAUM: Because I don't think he's
6 accurately portrayed the status of negotiations to Your
7 Honor. Your Honor, the Committee throughout this case has
8 taken strongly the position, and it is absolutely entitled to
9 do that, that there needs to be a litigation trust created
10 under a plan of reorganization, and it needs to be funded,
11 and it needs to be funded with \$3 million. That's been a
12 number that they've used for quite some time. And frankly,
13 the debtor has always expected that that will be a portion of
14 a plan. The debtors have acknowledged that they are not the
15 right party, they are not able to do the investigation and
16 the prosecution or the compromise of these claims. They
17 understand that their Board of Directors and their senior
18 management are the targets of this litigation. So, the
19 issue, Your Honor, is when do you make those final decisions
20 about who, how, when is the litigation going to be done? The
21 debtors answer to that is you do it in the plan of
22 reorganization, and we are ready, willing, and able, prepared
23 to negotiate that. I believe, Your Honor, contrary to what
24 Mr. Traub has said, that we are very close to achieving the
25 budget that the Committee has asked for in order to fund the

1 emergence of wind-down costs. And just to be very specific,
2 Your Honor, the debtor had put together a budget of twenty-
3 six and a half million dollars, is the cost for curing leases
4 that need to be cured, paying administrative expenses that
5 need to be paid in winding down the estate, reconciling
6 claims in funding litigation. We are about a million and a
7 half dollars apart with the plan -- potential plan funder on
8 funding that budget. The creditors don't need to have
9 standing today to negotiate that with this plan funder.
10 They've been negotiating it with this plan funder for eight
11 months. We can deal with that issue, and we can resolve that
12 issue as part of a plan of reorganization. That's what plans
13 of reorganization are for. That's what Chapter 11 is about,
14 is to get parties together to negotiate and settle their
15 differences. It's not to try and resolve issues in advance
16 and say, this is written in stone forever. Leave it on the
17 table, let the parties resolve it. I believe that this plan
18 fund is going to satisfy the Committee on the budget --

19 THE COURT: I am going to tell you, I am going to
20 give you a chance to put it together, and I'm going to
21 encourage that people don't start litigating until that
22 effort's been spent. I don't know how much time we need.
23 I've heard the word sixty days, ninety days, whatever it is,
24 and, you know, I could -- Well, I'm going to do this: Now we
25 get to the injunction. Is there anything further that you

1 want to say on this?

2 MR. POLEBAUM: Yes, Your Honor. I mean the
3 injunction is a lot, but I would like to --

4 THE COURT: Well, I'm going to get to that in a
5 minute, but I'm gonna change the subject. Yeah, Big Lots
6 wants to say something.

7 MR. MARWIL: May I be heard with respect to
8 standing, Your Honor?

9 THE COURT: Sure.

10 MR. MARWIL: Mr. Traub is right in certain respects
11 about our position. We are not unaligned with respect to
12 wanting to see the Creditors Committee in standing to pursue
13 the insider defendants on fraudulent conveyance grounds on
14 behalf of the operating debtor subsidiaries. Now there's a
15 big difference between representing the creditors of the
16 operating subsidiaries, which is who they represent, and
17 representing Big Lots as the only unsecured creditor, and
18 frankly only real creditor at HCC. And there is an inherent
19 conflict if they're representing both. And what we're
20 suggesting as part of standing is, grant them standing with
21 respect to the operating subsidiaries and allow them to
22 proceed on their fraudulent conveyance point. Our lawsuit is
23 not a fraudulent conveyance claim. It is a direct claim for
24 breeches of fiduciary duty, fraud, to seek legal gain, unjust
25 enrichment; okay? And our lawsuit to the extent that we can

1 settle it, great, but the Creditors Committee can't settle
2 our lawsuit without somehow compromising the operating debtor
3 creditors' recovery and vice versa. So we have to be there
4 to protect ourselves on behalf of HCC.

5 THE COURT: And what you say may be the price of
6 having a confirmable plan, but I -- it may require some
7 movement, but anyway, go on.

8 MR. MARWIL: And as far as the -- I don't know if
9 it did -- if it's an implicit threat in the being in debtors'
10 papers about a trustee coming in if the standing has to be
11 granted and somebody else has to do this. Our view is, you
12 know, if we have to appoint a trustee, we have to appoint a
13 trustee. It's not that big a deal. It's basically swapping
14 out the Board of Directors and putting in the trustee. I'm
15 sure that all of management and the directors will coordinate
16 and cooperate with the trustee that comes in, and maybe Mr.
17 Traub's right, maybe we can negotiate quickly, fairly, and
18 independently with the trustee about a reorganization and
19 about how to go after the insider defendants who got all of
20 this money and who harmed us. Harmed us for \$45 million.
21 And so, you know, if there are key members of management that
22 need to be retained, we can put an additional program in
23 place. Whatever is necessary to keep the debtor operating
24 but operating under the flag of independence and not
25 operating and making decisions that when you peel back one

1 layer of the onion, it's obvious that decisions are being
2 made to benefit the insider defendants in connection with
3 their personal liability to Big Lots and to the unsecured
4 creditors. And that's not right. So --

5 THE COURT: What can I do about it?

6 MR. MARWIL: I think that -- two things: Standing
7 to the Creditors Committee with respect to the operating
8 subsidiaries and allow us to proceed in our state court
9 lawsuit, the way we're doing, and, you know, frankly, Your
10 Honor, from what I've heard from both Mr. Polebaum and from
11 Mr. Traub, within ninety days, both of them agree there's
12 going to be a deal or it breaks up. We're not doing anything
13 in the state court law suit for the next ninety days. We've
14 agreed not to pursue discovery for the next ninety days. No
15 irreparable harm. What are we all doing here?

16 THE COURT: Okay. When you say "discovery", any
17 discovery. If you're going to go out to third parties, they
18 want to be there with something.

19 MR. MARWIL: What we have said is the hundred
20 thousand pages of documents that the Committee already got,
21 that we know is sitting in some law office somewhere in
22 boxes, give us that. We'll sit tight for ninety days.

23 THE COURT: Okay. Okay, thanks. I think they've
24 beat it to death. Does anybody else want to say anything?
25 Any new people?

1 MR. BUTZ: Yes.

2 THE COURT: Go ahead.

3 MR. BUTZ: Good afternoon, Your Honor. Daniel Butz
4 from Morris, Nichols, Arsht & Tunnell on behalf of Bain
5 Capital Fund Seven LP. With me in the courtroom today is
6 David Elkind. He's an attorney with Ropes & Gray and he's an
7 attorney in good standing, admitted in the state bars of New
8 York and the Central and Eastern District of New York. I ask
9 that he be heard today.

10 THE COURT: Sure, of course.

11 MR. BUTZ: Thank you, Your Honor.

12 MR. ELKIND: Good morning -- Good afternoon, Your
13 Honor.

14 THE COURT: Okay.

15 MR. ELKIND: Your Honor, as I sit and listen, I've
16 tried to bide my time. I've heard a lot of things from Mr.
17 Traub. We've had a lot of discussions with Mr. Traub. It's
18 very easy for arguments to be made and assertions to be made
19 to gain legitimacy because they're repeated, because they're
20 repeated by two parties who want to be plaintiffs and
21 accusations to be made. I do want to respond to them, Your
22 Honor, and I want to address the issues before the Court
23 because there have been a lot of mischaracterizations of both
24 the facts and the issues.

25 THE COURT: Okay, get with it.

1 MR. ELKIND: And I will. Your Honor, the
2 recapitalization that was done in April of 2002 was done at a
3 time when this company had overwhelming shareholder equity
4 and overwhelming net worth and overwhelming working capital.
5 And that continued to be the case after the transaction was
6 done.

7 THE COURT: I read that in your brief.

8 MR. ELKIND: Okay, and I want to emphasize that,
9 that the claims that are made over and over again that this
10 company was insolvent are absolute nonsense. And you will
11 deal with them at an appropriate time in court, and I urge
12 Your Honor not to accept them, not to lend them credibility
13 simply because they've been repeated by two parties who want
14 to bring a lawsuit. Let me now address the issues that Your
15 Honor does have before you, and those are the issues of
16 standing. They relate to the issue of who ought to bring
17 claims or ought to have standing to bring claims. They
18 relate to the issue of when claims ought to be brought. When
19 standing ought to be granted and the timing and the plan
20 negotiations. Let me address many of the issues that were
21 touched upon, Your Honor.

22 THE COURT: Go on.

23 MR. ELKIND: Your Honor, when KB filed for
24 bankruptcy, there was widespread reporting in the press as to
25 the reasons why it filed. And the reasons why it filed were

1 not a recapitalization done two years earlier. The reasons
2 why it filed were very clear and they were a situation in
3 which Wal-Mart was able to sell product at prices below,
4 below where KB was able to buy it. There was no way KB could
5 survive or any other company could survive in those
6 circumstances.

7 THE COURT: I read that in your brief.

8 MR. ELKIND: Okay, okay, Your Honor. And that's
9 why not only KB but a number of companies were forced out of
10 this business, including Schwartz and now Toys-R-Us wants to
11 exit the business. That's the reason why -- that's the
12 reason, and I urge Your Honor not -- Your Honor, the point --
13 there are limited resources in this estate, and the company -
14 - neither the company nor the shareholders of the company
15 would ever presume to settle a case with themselves nor could
16 they. We can't settle claims against ourselves. We will not
17 investigate claims against ourselves. The company will not
18 investigate them. The company will not settle claims. The
19 company will not compromise claims. That is a foregone
20 conclusion, and the arguments that to the contrary are
21 nothing more than a straw-man. There is no doubt that any
22 settlement here has to be with the creditors of this estate,
23 with the Committee and/or with the creditors of this company,
24 period. We accept that. We cannot investigate. That is not
25 the issue. That is not the issue here. The issue here is if

1 the claims are to be pursued, by whom should they be pursued?
2 There can be no question here that the three members of the
3 Committee consisting of toy manufacturers, they have every
4 incentive and desire to use the company's resources not to
5 pursue claims against Wal-Mart which is their client, their
6 principal customer, not to pursue the claims against
7 themselves, the claims that are suggested by what was
8 reported in the press at the time these companies failed.
9 They will not do it. They've asked for \$3 million here not
10 to investigate and pursue all claims, but only to pursue
11 claims against insiders, against related recapitalization
12 transactions. Similarly, Your Honor, there have been -- I
13 don't know what the total amount of fees have been that have
14 been billed to this estate by the Creditor Committee, but if
15 Your Honor looks at the time charges, it is clear that there
16 has not been for the hundreds and hundreds and hundreds of
17 thousands of dollars of time charges billed to this estate,
18 maybe millions, I don't know the exact number, there has not
19 been a penny, a penny spent on investigating the claims of
20 the toy manufacturers here. Not a single --

21 THE COURT: All right, I've read this in your
22 brief. Go on, speed it up.

23 MR. ELKIND: So, Your Honor, in a nutshell, if
24 there were claims to be pursued, they can and they should be
25 given to a trustee, whether it's a liquidating trustee

1 pursuant to a Chapter 11 plan or a Chapter 7 plan. If there
2 were conversion within three months there would be a -- or
3 four months or whatever schedule Your Honor set, there would
4 be a Chapter 7 trustee, the claims would belong to him
5 including the claims that Big Lots is asserting. Those are
6 claims of the estate. And so, the issue is not whether
7 claims should be investigated but whether they should be
8 handled and put under the charge of a party that is free of
9 conflicts. That's what we're saying.

10 THE COURT: And who would you suggest?

11 MR. ELKIND: Your Honor, what I'm suggesting here
12 is the following: That as Mr. Polebaum said, quite
13 articulately and as Your Honor expressed, this case needs to
14 be brought to a conclusion. This has been a -- the last
15 month, and as long as there are fights about litigation, have
16 been a complete distraction to this company particularly at a
17 time when this company is trying to make an effort to deal
18 with, negotiate with a buyer, and those negotiations are
19 between potential buyers and the Committee. We are not doing
20 those negations and we are not settling anything. I believe,
21 very strong, very strongly, Your Honor, that the interest of
22 moving this case forward, the interest of protecting the
23 interest of creditors as a whole, the interest in preserving
24 this company, the interest in maximizing value, the interest
25 in not chasing away employees of this company -- these guys

1 want to be suing employees of the company --

2 THE COURT: Okay, get to it.

3 MR. ELKIND: -- necessitate that, as Mr. Polebaum
4 pointed out, that parties cool down for three months,
5 negotiate. Claims aren't going to go away. We'll negotiate
6 with the Creditors Committee and that parties explore whether
7 they can work something out and within three months we should
8 know whether this is going to be a 7 or it's going to be an
9 11.

10 THE COURT: All right, I want to tell at a 7, a
11 trustee would be good, is a very --

12 MR. ELKIND: Absolutely right. Absolutely right,
13 and so, within three months, if that's the schedule that Your
14 Honor sets, there would be a Chapter 7 trustee, if there
15 would either be a plan, in which case there would be a
16 liquidating trustee. Of course it would be a liquidating
17 trustee to pursue any claims including claims against us, our
18 clients, including claims against the members of the
19 Committee, and that would be the right person to do it if
20 there were a plan. If there's no plan, there's going to be a
21 Chapter 7 trustee as Your Honor points out.

22 THE COURT: And that's a plan.

23 MR. ELKIND: And a Chapter 7 trustee in that case,
24 has all the rights to sue anybody and everybody and a Chapter
25 7 trustee can sue not only us but it can also look at what

1 actually happened and sue the members of the Committee. So
2 what we're urging, Your Honor, the counsel for the Committee
3 is very candid. There's no need for them to commence, pursue
4 litigation for three months, and I think it highlights the
5 fact, Your Honor, that there's not a bit of prejudice being
6 suffered here by allowing the -- by leaving the situation
7 where the parties are not sitting there squabbling, hiring
8 lawyers, litigating. Management's not being demoralized.
9 You've got potential buyers who don't know -- who don't know
10 whether the management of the company that they want to buy
11 are going to be on the butt-end of a lawsuit from a Creditor
12 Committee. These are not things that you need when you're
13 trying to sell a company, when you're trying to restructure a
14 company, and when you're trying to get a plan done.

15 THE COURT: Okay, I've got that, thanks.

16 MR. ELKIND: Thank you very much.

17 THE COURT: Anybody else want to say anything?
18 Make it short; would you?

19 MR. DUHIG: One minor point, Your Honor.

20 THE COURT: All right.

21 MR. DUHIG: Good afternoon, Your Honor. Peter
22 Duhig of Klett Rooney Lieber & Schorling. I'd like to
23 introduce Jeffrey Ganz.

24 THE COURT: Mr. Ganz.

25 MR. GANZ: Your Honor, Jeffrey Ganz from Riemer &

1 Braunstein on behalf of Fleet Retail Group, the debtor in
2 possession lender here. I think I understand the way Your
3 Honor is thinking about a Chapter 11 trustee, but I also
4 think I would --

5 THE COURT: I'm not thinking about a Chapter --

6 MR. GANZ: I understand --

7 THE COURT: I'm thinking about a Chapter 7 trustee.

8 MR. GANZ: That's what I do understand from the
9 comments you've made today about a Chapter 11 trustee, but
10 because requests have been made and that issue has been
11 discussed, I think it would be remiss of me to not mention to
12 the Court that the appointment of a Chapter 11 trustee does
13 represent a default, an event of default under the current
14 debtor-in-possession financing. Now, I can't tell you what
15 exactly the lenders would do because we haven't considered
16 what we'd do in the event that that occurred, but I think it
17 would be remiss if I didn't mention that point to the extent
18 that the other parties are having this discussion.

19 THE COURT: Well, you know, almost every loan
20 agreement inside and outside of bankruptcy has a clause like
21 that.

22 MR. GANZ: I'll have a seat.

23 THE COURT: And I think you know how they survive.

24 MR. GANZ: I will have a seat, Your Honor, thank
25 you.

1 THE COURT: Okay. I mean, the people that draw the
2 documentation always put that in, and I --

3 MR. GANZ: They asked me to make that comment.
4 Thank you, Your Honor.

5 THE COURT: All right. Pass on what I said to
6 them.

7 MR. BRODY: Your Honor, Mark Brody on behalf of
8 Angelo --

9
10 THE COURT: And that was a threat. If it goes into
11 7 and 11, they're going to pull the chain on the financing or
12 they have the authority to pull -- you always have the
13 authority to pull the chain, I guess, I guess --

14 MR. GANZ: Your Honor, please don't make that
15 mistake in assuming what I said was a threat, because we've
16 communicated with the parties in this room to let them know
17 our position and our position is that we have not considered
18 how it would work out.

19 THE COURT: I'd like to get a plan in here, an
20 amicable plan, but --

21 MR. GANZ: I think that that's essential.

22 THE COURT: -- anyway, go on.

23 MR. BRODY: Your Honor, Mark Brody on behalf of
24 Angelo Gordon. As Mr. Traub indicates we do in fact support
25 the Committee's motion, but what we're primarily concerned

1 about here is exclusivity. We share Your Honor's concerns
2 that fourteen months has come and gone and we don't seem to
3 be anywhere. I found Mr. Elkind's remarks particularly
4 interesting in that, you know, he places the blame on this
5 bankruptcy squarely on Wal-Mart. Wal-Mart's still there.
6 Target's still there. The competition is still there.

7 THE COURT: Oh, come on. I don't want to get into
8 this.

9 MR. BRODY: No, all I'm saying, Your Honor, is that
10 Mr. Polebaum said that they're about a million and a half
11 apart with a potential buyer. That's a gap they should be
12 able to close in thirty days. If we're not coming back here
13 for another sixty to ninety days, what will happen in the
14 meantime.

15 THE COURT: Okay, who do you represent?

16 MR. BRODY: Angelo Gordon, Your Honor. We're owed
17 approximately \$20 million.

18 THE COURT: That's a lot of money.

19 MR. BRODY: Yes, it is, Your Honor. And what we
20 believe is, we believe that any extension of exclusivity
21 should be thirty days so that the parties have a chance to
22 come back here in a month, let Your Honor know what's going
23 on. Let Your Honor know if they've made progress to a plan,
24 and if they haven't, at that point we should consider our
25 options. If we're not coming back here for another ninety

1 days, at that time we may have no options but a Chapter 7
2 trustee as much as our view is that that is not going to be
3 the right way to go. So, we think at the very least a
4 thirty-day extension is what will keep the parties' feet to
5 the fire and allow all of us to reevaluate the situation in
6 thirty days' time rather than in sixty or ninety.

7 THE COURT: I might tell you I like a Chapter 7
8 trustee more than I like a Chapter 11 liquidating. That's my
9 own biases, and I can be talked out of that, of course, and
10 I, you know, if it comes along in a plan, that's the plan,
11 but I'm just telling you Chapter 7 has its own plan and its
12 own momentum which I -- from experience, I think is not bad.

13 MR. TRAUB: Under certain circumstances, Chapter 7
14 is a much better way to go. In a situation like this, where
15 there's a lot of operations, if you'll give us a chance, keep
16 your mind open, I think an 11 would work.

17 THE COURT: I would, and this is different, you're
18 right. And I guess the major assets in this case, I think I
19 assume it's the leases and the staffing, the management --

20 MR. TRAUB: Wholesale businesses, separate
21 businesses, people's view of skinning it down, different
22 types of things. It's not just a everything's for sale.
23 It's not that way.

24 THE COURT: Go ahead.

25 MR. DEHNEY: Your Honor, I'm also going to be

1 quick. We filed the objection where ASM -- I'm not sure if
2 Your Honor reviewed the objection on exclusivity. Everything
3 we've heard about in the debates back and forth, we agree
4 with Angelo Gordon. The professionals and the parties here
5 should be able to hammer out a deal in thirty days. A lot of
6 professional fees are going to be spent if you go
7 sixty/ninety days, and if it's a million and a half dollar
8 gulf with the buyer, that should be arrived at pretty
9 quickly, and we would not like to be here in ninety days.

10 THE COURT: Thirty days is nothing in the way
11 lawyers work.

12 MR. DEHNEY: And, Your Honor, if it were at the
13 beginning of the case, I would agree, but you've had fourteen
14 months, and we've recited in our objection everything that's
15 gone on and everyone has agreed. They've negotiated for
16 fourteen months, pursued different alternatives. There's a
17 million and a half that separates a deal from no deal, and
18 thirty days, Your Honor, they should be able to get a deal
19 done.

20 THE COURT: Okay, thanks.

21 MR. KENNEY: Good afternoon, Your Honor. Mark
22 Kenney for the United States Trustee. First of all, Your
23 Honor, thirty days --

24 THE COURT: Oh, I've been waiting for you.

25 MR. KENNEY: I don't know if that's good or bad,

1 Your Honor.

2 THE COURT: No, no, no, I -- You may have a client
3 that doesn't have any money involved.

4 MR. KENNEY: That's very true, Your Honor. I see
5 how they are on their quarterly fees. Your Honor, I think
6 one of the biggest issues and it's funny because I hear, you
7 know, there's a lot of personalities involved here and a lot
8 of issues, but the biggest issue is going to be, can this
9 business be fixed in the first place, and it sounds like,
10 well you still have an operating debtor, and maybe there's a
11 chance of fixing it so that in that respect maybe, you know,
12 talk about putting a Chapter 7 trustee, you're basically
13 talking about the demise of the debtor which, you know,
14 according to Mark Twain, reports of his demise may be a
15 little premature, and maybe we don't want to start killing
16 the debtor now by even talking about that unless we're really
17 sure it can't be -- the business can't be fixed. I think,
18 Your Honor, the decision whether the business can be fixed, I
19 think, has to include a decision on who's going to pursue the
20 estate's claims against insiders. And I don't know that
21 that's something you can say, well, let's wait until we get a
22 plan in place and we're just going to appoint some neutral
23 third party, okay. In almost every plan that I see, Your
24 Honor, you're going to have somebody selected by the
25 Creditors Committee, okay? or the new shareholders who are

1 usually going to be the former creditors of the company
2 that's going to make the decision on who to bring in. And if
3 that's the case, well, why not start looking to the people
4 right now, look into the creditors now to get a decision on
5 who's going to control that litigation. It sounds to me like
6 the litigation is going to take place.

7 THE COURT: Well, who knows? The insiders may
8 deposit \$108 million.

9 MR. KENNEY: I think I lot of people would be happy
10 if that would happen, Your Honor, but --

11 MR. TRAUB: Let's go home.

12 MR. KENNEY: I'm going to be a lot older and a lot
13 grayer before that ever happens, Your Honor, and if that's
14 the case, you know, why not start focusing early on who's the
15 appropriate party to handle litigation?

16 THE COURT: What are you suggesting?

17 MR. KENNEY: Well, Your Honor, I think the idea of
18 having any kind of a trustee may be rather extreme, and I
19 think that perhaps that was found out there because that is
20 basically the equivalent of saying we're going to blow
21 ourselves up if we don't get our way, okay? It's very
22 common. I mean, in most cases that I've been involved in, it
23 is ultimately the Committee or the Committee's constituency
24 against the unsecured creditors who are going to control
25 those causes of action anyway. Do we really need to delay

1 making a decision on that? Maybe that becomes a major
2 element of a plan of reorganization, and dealing with it
3 today lets us know what we can get into a plan.

4 THE COURT: Are you favoring the Committee's --

5 MR. KENNEY: At this point we are, Your Honor. We
6 think that that the Committee is normally the most natural
7 person to pursue it. I understand there's some allegations
8 that there are conflicts of interest because of certain
9 members of the Committee, and that may be true. I don't want
10 to commit whether there are or are not conflicts, but if
11 there are that kind of conflicts, do you then wall off the
12 people with the conflicts so that the remaining members of
13 the Committee can pursue that kind of -- pursue the estate's
14 causes of action? And if we want to talk about the
15 conflicts, I understand --

16 THE COURT: What conflicts? Make sure I
17 understand. You're talking about people on the Committee
18 that deal with suppliers that had a lot to do with the last
19 season of bad results.

20 MR. KENNEY: Your Honor --

21 THE COURT: Are you talking about -- Is that what
22 you're talking about?

23 MR. KENNEY: Sometimes it's almost better to map it
24 out.

25 THE COURT: I think I know what you're --

1 MR. KENNEY: And I think basically you've got --

2 THE COURT: I don't want to malign any or libel or
3 slander anybody. Let's go easy.

4 MR. KENNEY: Essentially, Your Honor, you have
5 basically certain people saying that the company's financial
6 problems are the result of predatory pricing, which I guess
7 can be antitrust violations which would include potential
8 violations by toy suppliers, and I guess that would be the
9 defense to their fraudulent conveyance action that the
10 company was solvent at all times, and it was strictly results
11 of antitrust violations by third parties, and they would
12 implicate members of the Committee who are toy suppliers.
13 But that is fifty percent of the current Committee. We do
14 have a vacancy on the Committee created by Big Lots'
15 resignation from the Committee, and we are looking -- I mean,
16 we've had a request to fill that vacancy. We are looking
17 very seriously at filling that vacancy. So that I think you
18 can still wind up with a committee that if need be is going
19 to be a sub-committee, but --

20 THE COURT: That's one solution.

21 MR. KENNEY: It's a significant and I think it's a
22 workable solution, Your Honor, but more important than that,
23 I think that to even know whether they're going to be able to
24 put together a viable plan, you really need to deal with that
25 issue up front.

1 THE COURT: I realize that, and I -- What would you
2 suggest? I heard thirty days, sixty/ninety days.

3 MR. KENNEY: Your Honor, it could be that the
4 ability to put together a plan in the first place is going to
5 depend on knowing who's going to have the standing and who's
6 going to be pursuing those claims in the first place. And I
7 don't know if Your Honor wants to say today, Look, we'll
8 decide the standing issue today and give them thirty days to
9 come up with a plan before --

10 THE COURT: Oh, no, I'm --

11 MR. KENNEY: -- or we'll give them thirty days, you
12 know, we'll make a decision on standing in thirty days and
13 give them sixty days to come up with a plan, okay? But I
14 think it's very difficult to come up with a plan in this case
15 without resolving the standing issue. Now, maybe what you
16 come up with is two separate plans. Maybe let the debtor put
17 a plan on the table and let the Committee put a plan on the
18 table.

19 THE COURT: Well, if I rule in favor of the motion
20 for standing by the Committee and then set some time limits,
21 would that help?

22 MR. KENNEY: I think it would help, Your Honor.
23 And I think, obviously, just with everybody knowing who's
24 going to be dealing with those claims, even if they're not
25 pursued right away.

1 THE COURT: And ask the Committee to -- if they're
2 going to start going to court, that they do it --

3 MR. TRAUB: We give some notice.

4 THE COURT: Give some notice.

5 MR. KENNEY: I think that would be appropriate. I
6 think -- and it's more important that -- to be able to move
7 this case off the dime because I think right now it's just --

8 THE COURT: It's heated up.

9 MR. KENNEY: It's spinning -- It's heated up but
10 the wheels are spinning.

11 THE COURT: Okay.

12 MR. KENNEY: And I think what we need to do is give
13 it a nudge, you know, it's like --

14 THE COURT: Well, I'm going to tell you, this is
15 the last chance. Either there's going to be a plan or there
16 isn't going to be a plan, and we're going to know that in the
17 next couple of months, and I guess what I'm going to say is
18 that I know a Chapter 7 trustee doesn't have any conflicts or
19 wouldn't have any conflicts that they're concerned about now,
20 and I think with that comment, I'll let you think about it.

21 MR. KENNEY: I understand that, Your Honor, at the
22 same time that with a Chapter 7 trustee the company is dead,
23 and that -- I think that's antithetical to everybody's
24 purposes.

25 THE COURT: That's very true. A Chapter 7 trustee

1 can sell, and he can be an operating trustee, but maybe he --
2 I know maybe in the marketplace he has a disease and that
3 probably is --

4 MR. KENNEY: Well, that's a kind way to
5 characterize it.

6 MR. FOX: The 7 trustee, Your Honor, you have a lot
7 of moving parts. I'm Michael Fox, Traub, Bonacquist. We
8 just don't think that that's the way it would maximize the
9 value to the entire estate. It may, Your Honor, address the
10 conflict issue that you're addressing, but there's so many
11 assets to that need to be distributed, marketed, and sold in
12 an orderly fashion, I don't believe a 7 trustee is just too
13 much of a knee-jerk reaction to cause --

14 THE COURT: Okay, okay, yeah.

15 MR. MARWIL: Your Honor, there is a way, I think to
16 solve both parts. And remember that we've got the holding
17 company structured here. Your Honor can appoint a Chapter 7
18 trustee for HCC, and that Chapter 7 trustee could deal with
19 the litigation and give direction -- or elect a new board if
20 it wanted to for the operating companies and it will still be
21 in Chapter 11 that can operating and that can try to propose
22 a plan. HCC, that entity that's different than the operating
23 companies, and it can't be lumped in either on a standing or
24 on a trustee or on operations. It's different. And the
25 creditor constituency, which is us, is different.